Cycles and Pendulums: Good Faith, Norms, and the Commons

Claire Moore Dickerson

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Cycles and Pendulums: Good Faith, Norms, and the Commons
Claire Moore Dickerson*

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I. Introduction

During my dozen years in commercial practice, I was first surprised and then reassured by the number of times that I saw business people on both sides of a transaction behave according to a standard higher than that demanded by applicable law. I remember one incident with particular clarity: the chief executive officer of a publicly held company refused to take advantage of a contractual ambiguity and said that the interpretation which favored the other party was what the parties originally intended. This executive officer was in a difficult situation: the shareholders might criticize the failure to take the last inch, and because the executive was a significant shareholder, there was further personal incentive to consider only the shareholder perspective.\(^1\)

In contrast to this anecdote, consider the developing trend in unincorporated businesses. We have progressed (if that is the correct term) from a very high standard of behavior applicable to partnerships toward the much lower standard of many recent statutes applicable to unincorporated businesses such as partnerships or limited liability companies. Although some business people are operating at a high standard, others are organizing a concerted attack on that standard.

In contemplating the anecdote on the one hand, and this trend in unincorporated businesses on the other, I am guided by two principles. First, the standard of performance applicable in the business community is a norm that lies on a continuum stretching from contract law’s good faith norm to trust law’s fiduciary duty norm. The location on the spectrum is

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1. As is the case with any anecdote, this is only an anecdote. All of us have less heartwarming but more amusing stories of abuse. In addition, the chief executive’s behavior can be interpreted as thoroughly cynical: perhaps, in the context of a relatively closed industry, this apparently principled behavior was no more than the only commercially intelligent response. For example, consider the discussion of game theory and the prisoner’s dilemma. See Robert Axelrod, The Evolution of Cooperation 10-11 (1984) (discussing game theory and prisoner’s dilemma). Or perhaps it was the chief executive’s concern for personal reputation that influenced the result. See Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 AM. SOC. REV. 55, 64 (1963) (discussing how development of bad reputation can have detrimental effects on business).
determined by the actor’s conflict of interest and dominance. That is, in contrast to the assertions of the lawyer-economists, the playing field is not level and the standard of performance takes that into account as a practical matter. Second, the business community’s standard of performance on the good faith spectrum is a reservoir of good will and trust. This reservoir is the "commons" of the business arena. Consequently, it is not only defensible but appropriate that our legal system supports the standard. The law should support — not erode — the standard of performance applicable to unincorporated businesses.

These principles spawn corollaries. Because the standard of performance is a norm, it can be supported, modified, or destroyed by concerted action, including by legal action. Thus, law can support, and law can destroy. When law supports, it pushes behavior that protects those who are more vulnerable. As the law continues to push in that direction, it gains momentum much like an epidemic. Then the pendulum swings past the point of equilibrium. That is when the roles are reversed. The once vulnerable party, now overly protected by preexisting law, becomes dominant. Normally, the overarching norm of good faith will then reverse the process. The evolving regulation of insider trading in securities presents a clear illustration of the pendulum’s slow but inexorable swing in the direction of a higher standard of behavior during the better part of this century, and of its apparent, recent reversal in direction.

As noted, however, the law not only can support a norm, it can destroy one as well. The current trend in unincorporated businesses may well be destroying the good faith norm in that sphere. If the trend erodes the commons sufficiently, the good faith pendulum will no longer swing back on its own and will further destroy the commons.

Part II of this Article defines the relevant standard of performance as the good faith norm and describes the spectrum from contract law’s good faith norm to trust law’s fiduciary duty norm. Part III focuses on the relationship between the good faith norm and the law, including how the law supports and modifies this norm. However, the law’s ability to modify the norm does not help us decide how the law should seek to affect the good faith norm. Accordingly, Part IV discusses the analogy between the good faith norm and the commons. For instance, a failure to protect the good faith norm — by allowing the unincorporated businesses to veer from a standard that accounts for the parties’ relative dominance and conflict — is a destruction of the commons. It is for this reason that law should support the good faith norm. Therefore, we should reconsider the trend in statutes applicable to unincorporated businesses.
II. Good Faith Norm Is a Standard of Many Levels

When sociologists speak of norms, they generally are referring to behavior patterns internalized by the participants. Because we cannot take a CAT scan to determine the motivations for particular patterns of behavior, we are relegated to observing objective manifestations. Therefore, sociologists would recognize a norm if, for example, a person behaves in a particular way despite lack of supervision. As lawyers, we are familiar with the concept of objective intention; we are accustomed to determining the deemed intention of a person based on outward manifestations.

For purposes of this Article, a norm is a pattern of behavior by a significant number of participants that, given overt manifestations, appears to have been internalized. The behavior can be explained by the proposition that the actor believes it preferable for whatever reason — be it self-interest or a sense of morality — that those acts be accomplished. In applying this framework to standards of performance, if business transaction participants tend to behave in accordance with a standard higher than that required by law, the standard has been internalized and reflects a norm. This behavior provides the best evidence that a norm has been created. To the extent that I have found such evidence, I use it. In addition, I have used standards long imposed by law as further evidence of an existing norm because, even if the behavior is only to the level required by law, good faith as a standard may still have been internalized: supervised performance does not mean that compulsion is the only explanation. For purposes of this Article, a norm is overt behavior not incompatible with applicable law, although I will emphasize those areas in which the evidence is particularly strong that behavior has been internalized.

3. See Hotchkiss v. National City Bank, 200 F. 287, 293 (S.D.N.Y. 1911) (L. Hand, J.) (addressing importance of objective intentions in contract formation), aff'd, 201 F. 664 (2d Cir. 1912), and aff'd, 231 U.S. 50 (1913); 1 E. Allan Farnsworth, Farnsworth on Contracts § 3.6 (2d ed. 1990); see also Restatement (Second) of Agency § 1 cmt. a (1958) (addressing importance of objective manifestations in formation of agency relationship).
4. Although the preference may be driven by a moral sense, see Turner, supra note 2, at 3, it also may be driven by a desire to conform to a group to which the actor would like to belong. See id. at 6 (using example of unemployed poor person seeking to behave as if rich); see also Alan Hyde, The Concept of Legitimation in the Sociology of Law, 1983 Wis. L. Rev. 379, 398 (recognizing theoretic possibility of different motivations).
5. See infra Part II.A (discussing Professor Macaulay's 1963 research). See generally Macaulay, supra note 1 (researching behavior in noncontractual business relations).
6. Turner, supra note 2, at 44 (public compliance may include private change).
A. Good Faith Is a Norm in the Business Context

That there is a standard of behavior is reflected in the writings of legal scholars who have been prolific in the business law arena. As we will see, some scholars have confirmed that the standard of good faith exists by documenting behavior of a standard higher than that required by law. Others have merely affirmed the existence of a good faith standard. Still others have expressly approved the existence of a minimum standard of performance higher than opportunism. The best evidence of the norm's existence would be an empirical study carefully teasing out the behavior of business people when supervision is absent. The weakest evidence is the view of students of commercial practice who articulate that they, as distinguished from actors in the commercial arena, have internalized a particular behavior. I have found the following evidence persuasive in the aggregate.

Empiricists have confirmed the existence of a good faith standard. In his famous 1963 article describing interviews with Wisconsin business representatives, Professor Stewart Macaulay showed that, at least in the particular context studied, businesses acted according to a standard that exceeded mere good faith—that is, the businesses exceeded the standard of performance legally required by the applicable contract. Analysis by both the game theorists and the relational-contract theorists supports this finding. Professor Macaulay's Wisconsin businesses appear to have been located in a sufficiently confined geographic environment to give rise to repeat business. The game theorists emphasize that the classic prisoner's dilemma channels the parties toward cooperation—at least as long as the first party cooperates but remains ready to retaliate if the other does not cooperate ("defects"), and as long as the parties perceive the iterations of their relationship to be infinite. Arriving at a similar conclusion by a different route, Professor Ian Macneil describes the long-term contract as

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7. Macaulay, supra note 1, at 55 n.3. Although all the businesses had contacts in Wisconsin, it is not clear that they all worked together. However, Professor Macaulay hypothesizes, as one possible explanation, that the businesses that performed beyond contractual obligations desired to continue their relationships. See id. at 63. This is also the explicit assumption of a prominent game theorist. See AXELROD, supra note 1, at 179 (this game theorist also assumes that superior performance evidences desire to continue relationship). But see Stewart Macaulay, An Empirical View of Contract, 1985 Wis. L. Rev. 465, 476 (suggesting that relationship will not sustain relational sanctions in endgame situations).

being "relational" and points out that the parties to such a contract behave according to a standard higher than mere good faith.9

After an exhaustive study of case law in different business contexts, Professor Robert Summers, an influential realist, has affirmed the existence of a good faith standard. Describing good faith, Professor Summers speaks of morality10 and finally is relegated to defining good faith in the negative: Good faith is anything that is not bad faith. We know bad faith when we see it, and Professor Summers certainly saw it in certain behavior censured by commercial law.11

Finally, the lawyer-economists, too, recognize a minimum standard and go on to approve the concept, albeit in their own vocabulary and grudgingly. In their writings, they betray discomfort — although lawyer-economists believe that persons who deal with each other should be able to describe the relationship they want, they have not eliminated the concept of an irreducible minimum standard of performance.12 Generally, lawyer-economists assert that the parties to a particular transaction are in the best position to value the exchange and, therefore, that the parties should be permitted to opt out of even default obligations.13 When asked to explain


11. See id. at 196, 206 (giving example of commercial bad faith). For example, Professor Summers specifically refers to "openly abusing the power to break off negotiations" as an example of legally proscribed bad faith. Id. at 210, 212.

12. See infra note 14 (discussing potential for abuse in cooperative relationships); see also Inge v. Glamore Motor Sales, Inc., 535 N.E.2d 1311, 1313 (N.Y. 1989) (Bellacosa, J.) (discussing termination of at-will employee). Although the case can be interpreted to suggest that the New York Court of Appeals approves of arbitrary behavior, see Gary Minda, Employment Law, 41 SYRACUSE L. REV. 265, 272-73 (1990), the decision can also be explained as an illustration of New York's position that the at-will employment doctrine trumps all rights of the employee, especially given Judge Bellacosa's dictum indicating that the employee might have obtained a better result had oppression been argued. See also Gallagher v. Lambert, 549 N.E.2d 136, 138 (N.Y. 1989) (Kaye, J., dissenting) (opining that, because shareholder-employee did not question his at-will status as employee, case's facts and issues differed fundamentally from those in Inge).

why they nevertheless favor a mandatory minimum standard of performance, the lawyer-economists respond that the standard of good faith prevents opportunism and that opportunism is indefensible because it is inefficient.\textsuperscript{14} Opportunism is inefficient in that it fails the Kaldor-Hicks test: although the opportunist presumably does benefit, the victim of the opportunism is harmed more than the opportunist benefits, and consequently, society as a whole loses.\textsuperscript{15} Because of this evidence and because of my own experience as illustrated by the anecdote that opens this Article, I agree that good faith standards represent a norm.

Therefore, we have seen that, in a business and commercial context, a minimum standard of performance exists, it is practiced at a level higher than that required by law, and it is viewed by at least some with expressed approbation. Not only is there a norm, but it may well have been internalized.

\section*{B. The Good Faith Norm Is on a Continuum from Good Faith to Fiduciary Duty}

Once we have established that good faith is a norm in the business context, we must determine what we mean by "good faith." I contend that good faith and fiduciary duty are on the same continuum.\textsuperscript{16} For purposes (arguing that, through finding parties' objective intentions, law should enforce parties' determination of their own self-interest rather than seeking to impose third party's view of efficiency).

\textsuperscript{14} See Market St. Assocs. v. Frey, 941 F.2d 588, 594 (7th Cir. 1991) (Posner, J.) (suggesting that opportunism is not permissible behavior because costs to monitor are too high); Posner, supra note 13, § 4.8, at 117-18 (positing that law can deter opportunism by imposing harsher sanctions on opportunistic breachor).

\textsuperscript{15} See Oliver E. Williamson, \textit{The Economic Institutions of Capitalism} 64-67 (1985) (explaining how opportunism increases transaction costs); Timothy J. Muris, \textit{Opportunistic Behavior and the Law of Contracts}, 65 \textit{Mich. L. Rev.} 521, 524 (1987) (same). A transaction achieves Kaldor-Hicks efficiency when the benefit to the winners would exceed harm to the losers. See Jules L. Coleman, \textit{Markets, Morals, and the Law} 84 (1988) (defining Kaldor-Hicks efficiency). Kaldor-Hicks efficiency is distinguished from Pareto superiority in that Kaldor-Hicks efficiency only requires the possibility of gain by the winners after compensation to the losers. Pareto superiority requires that the winners gain advantage without disadvantage to the nonwinners. See id. 84-86 (comparing Kaldor-Hicks efficiency to Pareto superiority); see also id. at 71-72 (defining Pareto efficiency terms); Deborah A. DeMott, \textit{Do You Have the Right to Remain Silent?: Duties of Disclosure in Business Transactions}, 19 \textit{Del. J. Corp. L.} 65, 71 (1994) (asserting that "opportunism" has varied meanings in cases and academic writing, but that "[a]ll such meanings convey moral disapproval").

of this discussion, I have reviewed the minimum standards imposed by law, but I recognize that because law is necessarily prescriptive,\textsuperscript{17} law may also force entirely noninternalized behavior. On the other hand, as described in the introduction to Part II, behavior that conforms to law may have been internalized. Indeed, even behavior comporting with an aspirational statute may have been internalized, but that is stretching the point more than necessary. I do not use cases based on the Uniform Commercial Code's (UCC) Article 2 precisely because Professor Karl Llewellyn arguably drafted the Article 2 standards not to reflect marketplace realities, but rather to propose standards that would take into account the relative power of the parties.\textsuperscript{18} Instead, I focus on common law as the better evidence of a true

\textsuperscript{17} See Frederick Schauer, \textit{Playing by the Rules} 2 (1991) (distinguishing prescriptive rules from descriptive rules).

\textsuperscript{18} See Karl N. Llewellyn, \textit{The First Struggle to Unhorse Sales}, 52 Harv. L. Rev. 873, 903-04 (1939) (opining that merchant law needed explicit form in present to build for future); Karl N. Llewellyn, \textit{Through Title to Contract and a Bit Beyond}, 15 N.Y.U. L. Rev. 273, 286 (1991) (attributing idea of continuum to Professor Coffee). Professor Coffee has discussed good faith and fiduciary duty in the context of corporations and has shown some consequences of applying these different doctrines originating from different sources in the corporate setting. See John C. Coffee, Jr., \textit{The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role}, 89 Colum. L. Rev. 1618, 1653-64 (1989) (examining similarities and differences between good faith and loyalty). However, although Professor Coffee did reflect on circumstances in which the result could be explained either in terms of good faith or in terms of fiduciary duty, see Coffee, supra, at 1655 (citing Deborah A. DeMott, \textit{Beyond Metaphor: An Analysis of Fiduciary Obligation}, 1988 Duke L.J. 879, 893), he did not consider the different levels of good faith. He focused on the reasons why a corporation is not a contract and on why a pure fiduciary duty is not appropriate either. See Coffee, supra, at 1659-62 (disagreeing with contractarians). Others who have considered the topic to varying degrees have emphasized procedural differences. See Dickerson, supra, at 959 n.19 (discussing those who base continuum on procedural differences); Marleen A. O'Connor, \textit{Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers}, 69 N.C.L. Rev. 1189, 1250-51 (1991) (distinguishing good faith from fiduciary duty on observation that burden of proof shifts between parties when moving from good faith to fiduciary duty). Others have emphasized historical differences. See Tamar Frankel, \textit{Fiduciary Duties as Default Rules}, 74 Or. L. Rev. 1209, 1225-26 (1995) (discussing separate growth, but opining that when contract and fiduciary law are both present, fiduciary standards prevail). Yet others have considered the existence of an intermediate standard to link up good faith and fiduciary duty, perhaps thereby implying something akin to a continuum. See Roberto Mangabeira Unger, \textit{The Critical Legal Studies Movement}, 96 Harv. L. Rev. 561, 642 (1983) (suggesting limited solidarity constraint as intermediate standard). With thanks to Professor Lawrence E. Mitchell for flagging this point to me, Judge Andrews, in his Meinhard dissent, included dictum in doctrinal support of a continuum containing both a trust law duty and good faith (although he was speaking only of express or implied trusts and not of purely contractual relationships). See Meinhard v. Salmon, 164 N.E. 545, 550 (N.Y. 1928) (Andrews, J., dissenting).
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norm. As described below, the common law reflects the continuum that contains good faith through fiduciary duty.19

In the context of commercial transactions, the lowest level of good faith may mean nothing more than the minimum standard required to prevent a contract from being illusory. In any event, this threshold prevents malicious, opportunistic behavior.20 As the power of the transactor (the fiduciary-analogue) becomes greater relative to the other party (the beneficiary-analogue), and especially as the transactor's conflict of interest increases, the standard of performance for the transactor moves along the continuum toward fiduciary duty. For example, if the tenant as fiduciary-analogue obtains an exclusive lease from the landlord as beneficiary-analogue, pursuant to which the tenant is to pay rent based on the tenant's own sales, the return on the landlord-beneficiary's investment will depend entirely on the tenant's effort and ultimate success. The tenant, in its capacity as the fiduciary-analogue under a percentage lease, has a significant conflict of interest: instead of maximizing sales, it may seek to maximize profits to control its rental payment. Under these conditions, the tenant as fiduciary-analogue is held to a standard that is higher than mere good faith.21


19. Cases either that predate the adoption of UCC Article 2 and its statutory predecessors or that lie outside the reach of UCC Article 2 reflect the common law. Therefore, because UCC Article 2 applies to the sale of goods, see U.C.C. § 2-102 (1992) (limiting Article 2 to sales of goods), a transaction that is not for the sale of goods will, generally speaking, be controlled by common law. In fact, the continuum exists in UCC Article 2 as well as in the common law, see infra notes 20, 22 (discussing U.C.C. §§ 2-103(1)(b), -306(2) (1992)).

20. See WILLIAMSON, supra note 15, at 47 (opportunism); Muris, supra note 15, at 524 (opportunism); Summers, supra note 10, at 200 (common law). For sales of goods between merchants, the UCC defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103(1)(b) (1992). This "objective" definition generally is considered to be higher than the generally applicable "subjective" definition. Id. § 1-201(19); see also Money Mart Check Cashing Ctr., Inc. v. Epicycle Corp., 667 P.2d 1372, 1373 (Colo. 1983) (defining subjective good faith as very low standard). This is logical to the extent that a nonmerchant who is acting can be expected to be less in control than a merchant. See Dickerson, supra note 16, at 980 n.95 (discussing standard applied to nonmerchant). But see supra text accompanying note 18 (concerning Professor Llewellyn's aspirational tone for UCC Article 2). Common law may therefore reflect realities more accurately than the UCC does.

Note that if the tenant pays a substantial minimum rent in the context of what is otherwise a percentage lease, the landlord as beneficiary-analogue will be less vulnerable and the tenant as fiduciary-analogue will have less incentive to focus on profits in lieu of sales. The fact that the tenant’s performance obligation slides back down to mere good faith when there is a minimum rental payment evidences that it is the combination of relative power and conflict that creates the higher standard.\textsuperscript{22}

A corollary of the argument that the actor’s conflict of interest and relative dominance determine the precise location of the standard of performance on the good faith and fiduciary duty continuum is that the parties should not normally be able to opt out of a higher level of good faith identified by the levels of conflict and dominance. In contrast, the contractarians support opting out as a possibility in contract formation. Further, because opting out is a contract law concept, the contractarians apparently interpret opting out itself as requiring only the lowest level of good faith.\textsuperscript{23} I disagree. At a minimum, the level of good faith for opting

\textsuperscript{22} See Food Fair Stores v. Blumberg, 200 A.2d 166, 174 (Md. 1964) (noting that there is no heightened standard of good faith, despite exclusive lease, when there was minimum rental); Dickey v. Philadelphia Minit-Man Corp., 105 A.2d 580, 582-83 (Pa. 1954) (noting that real estate lease required mere good faith standard when there was minimum rental). Essentially the same heightened standard applies in the case of sales of goods under the UCC. See U.C.C. § 2-306(2) (best efforts); see also Dickerson, supra note 16, at 983-84 (discussing higher "best efforts" standard applied to exclusive dealings).

\textsuperscript{23} Professor Ribstein has complained that the Revised Uniform Partnership Act (RUPA) does not allow enough waiving of fiduciary duty and that the good faith and fair dealing standard is too high. See Larry E. Ribstein, The Revised Uniform Partnership Act: Not Ready for Prime Time, 49 Bus. Law. 45, 57 (1993). He claims that full waivability has been possible under the Uniform Partnership Act (UPA). Id. (citing Wilson v. Button, 404 F.2d 309 (5th Cir. 1968); Hooper v. Yoder, 737 P.2d 852 (Colo. 1987); Covalt v. High, 675 P.2d 999 (N.M. Ct. App. 1983); Singer v. Singer, 634 P.2d 766 (Okla. Ct. App. 1981)). I disagree. Singer included an express agreement that the partners may compete with the partnership, and the court approved the limiting of the partnership’s scope to whatever the partners placed in their partnership agreement. See Singer, 634 P.2d at 772. However, the cases cited by Singer do not support the idea that any contract that is fair at formation is enforceable. Wilson recognizes that Indiana’s UPA § 18(f) expressly permits partners to agree to salary payments. See Wilson, 404 F.2d at 309. In Hooper, the court actually found a breach of fiduciary duty. See Hooper, 737 P.2d at 859-60. The Covalt case is more difficult. The court allowed a 50% partner of the landlord-partnership, who also had a 75% interest in the tenant-corporation, to block an increase in the rental payments because the court found that the partners must have anticipated and therefore impliedly approved a breach of that partner’s fiduciary duty. See Covalt, 675 P.2d at 1003. The
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out should be at the level determined by conflict and dominance, and because that can be determined with relevance only at the time of the subject transaction, opting out should be — as it is for classic fiduciary duty — only on an ad hoc basis.\(^{24}\)

In turning to fiduciary duty, we start at the opposite end of the spectrum and work back to the middle.\(^{25}\) If the continuum operates here, the level of fiduciary duty owed should decrease as the fiduciary's relative power and conflict decrease. The highest level of fiduciary duty is found in classic trust law. The trustee is in charge of the corpus,\(^{26}\) and in this situation, the conflict is evident: because the trustee has no interest in the benefits of the corpus, the more that the trustee can divert from the corpus, the more advantageous for the trustee. In this circumstance, the trustee is not to use its power for its own benefit: "The trustee is . . . to administer the trust solely in the interest of the beneficiary."\(^{27}\)

A trifle closer to good faith on the continuum is the partnership relationship. The actor-partner has power: a partner acting within the scope of the business can bind the entire partnership and create personal liability for all partners.\(^{28}\) There is conflict, too. As the acting party, a partner can create a transaction that benefits it more than — or even at the expense of — its partners. On the other hand, the conflict is less than that for a classic trustee because the partner is an owner of the partnership, and to the

other explanation for the court's approval of the apparent breach is that, rather than blessing a blanket waiver, the court was balancing competing duties — the 75% shareholder of the tenant, as an officer of the corporation, owed a fiduciary duty to try to keep the rent down. But even from that perspective, the decision to absolve the recalcitrant partner seems wrong: the fair rental value of the partnership's property was found to be 50% higher than the rent being paid. See id. at 1001. Therefore, refusing to allow an increase in rent looks like a clear breach of fiduciary duty by that recalcitrant partner. See Dickerson, supra note 16, at 973-74 n.75 (criticizing Covalt decision).

\(^{24}\) See Restatement (Second) of Agency § 390 cmt. a (1958) ("One employed as agent violates no duty to the principal by acting for his own benefit if he makes a full disclosure of the facts to an acquiescent principal and takes no unfair advantage of him."); see also supra note 23 (arguing against position that opting out is already allowed).

\(^{25}\) See Dickerson, supra note 16, at 985-91 (analyzing continuum from fiduciary duty end beginning with most stringent trust law rules, after analyzing continuum from contract law end, beginning with threshold good faith).

\(^{26}\) Restatement (Second) of Trusts § 186 (1957).

\(^{27}\) Id. § 170(1).

\(^{28}\) See Uniform Partnership Act (1914) (UPA) § 9, 6 U.L.A. 400-01 (1995) (partner's power to bind partnership); Revised Uniform Partnership Act (1994) (RUPA) § 301, 6 U.L.A. 33-34 (1995) (same); see also RUPA § 15 (partner's power to bind partners; liability collection rules); id. § 306 (partner's power to bind partners); id. § 307 (liability collection rules).
extent that the partnership (the analogue of the trust corpus) does well, the partner benefits. Even though the acting partner’s fiduciary duty is generally less than that of a trustee, it rises again if the partner has unusual power — for example, if the person acting is the managing partner. Again, the standard of performance on the fiduciary duty end of the spectrum should not be subject to opting out, except on an ad hoc basis and after taking into account the standard to be applied to the transaction.

The concepts underlying the standard’s level are therefore the same at both ends of the spectrum — the greater the acting party’s power and conflict of interest, the higher the standard. Conversely, as the acting party’s power and conflict are reduced, so is the standard of performance. For purposes of this Article, the good faith norm is found at both ends of the spectrum and at all points in between. Consequently, this good faith standard applies whenever we are accustomed to hearing either "good faith" or "fiduciary duty."

There is another point to emphasize. This good faith norm, at a level determined by conflict and power, applies to contracts and to business organizations — whether incorporated or not. It also applies to other commercial relationships — even to insider trading. Because I am using insider trading as an illustration, it is important to see that the good faith norm is relevant in this context. Consider insider trading in the following light: If we recognize the norm created by the nondisclosure (as opposed

29. The UPA reflects the dual role of the partner as a manager, see UPA §§ 9(1), 18(e), (h), and as an owner, see id. § 18(a). RUPA expressly recognizes the impact of this role by stipulating that a partner does not violate its fiduciary duty merely by furthering its own interest. RUPA § 404(e). Even more bluntly, shareholders are allowed to act selfishly. See, e.g., Harriman v. E.I. Dupont De Nemours & Co., 372 F. Supp. 101, 105 (D. Del. 1974); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976) (explaining in dicta that right to act selfishly is subject to fiduciary duty imposed on controlling, powerful shareholder). But see Thorpe v. Cerbco, Inc., 19 Del. J. Corp. L. 942, 954 (Ch. 1993) (dicta); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 516 (Mass. 1975).


31. See supra text accompanying note 24 (arguing that opting out should be allowed only on ad hoc basis and only if level of conflict and dominance permit).

32. As described in Dickerson, supra note 16, at 993-1000, I believe that the extent of harm, in particular "permitted harm," to the other party is also relevant in determining the level for the standard of performance. However, for purposes of this discussion, the combination of power and conflict is a sufficient explanation. For an interesting take on the dependence-dominate structure of fiduciary duty, see William W. Bratton, Game Theory and the Restoration of Honor to Corporate Law’s Duty of Loyalty, in PROGRESSIVE CORPORATE LAW 139 (Lawrence E. Mitchell ed., 1995).
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to the misrepresentation) component of Section 10(b) of the Securities Exchange Act of 1934 (1934 Act) to be broader than the classic command to "disclose or abstain," we can view the Section as prohibiting abuse by a dominant participant. Under the 1934 Act, the insider\textsuperscript{33} with material nonpublic information is perceived as being in a dominant position vis-a-vis other existing and potential investors in the company. The use of material nonpublic information is an abuse at the expense of relatively vulnerable investors. In more general terms, the insider has violated the relevant standard of performance, which in any event is no lower than contract law good faith.\textsuperscript{34} The 1934 Act, therefore, merely imposes a familiar standard located on the good faith continuum,\textsuperscript{35} but applies it to a new setting: dealing in securities.

III. The Good Faith Norm, Acting Synergistically with Law, Evolves as a Pendulum

In this Part, I will show that because the standard of performance on the continuum is a norm, it can be modified by norm entrepreneurs.\textsuperscript{36} So, how does law operate as a tool of the norm entrepreneurs?

Law can define and encourage behavior desired by the norm entrepreneurs, and it can do so by changing the risks and rewards.\textsuperscript{37} It can support

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33. The same analysis would apply to any Section 10(b) defendant, including a defendant who is not a classic insider, such as a tippee or a defendant in a misappropriation cause of action.

34. Scienter is the Section 10(b) standard. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). Scienter for these purposes includes recklessness. See Rolf v. Blyth Eastman Dillon & Co., Inc., 570 F.2d 38, 44-47 (2d Cir. 1978). Although scienter is defined in contrast to negligence, see Ernst & Ernst, 425 U.S. at 201, and is thus more a tort than a commercial concept, this does not mean that the dominance/conflict aspects of the good faith continuum are inapplicable. A person trading on or tipping material inside information with scienter is benefiting from the dominance created by the information and is conflicted because that person is able to benefit personally from the information.

35. See Dickerson, supra note 16, at 978-93 (discussing how good faith and fiduciary duty are on same continuum). Even if good faith and fiduciary duty are not on the same continuum, both are existing norms.


37. See H.L.A. HART, THE CONCEPT OF LAW 81 (2d ed. 1994) (primary rules create duties); Robert D. Cooter, Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant, 144 U. PA. L. REV. 1643, 1654 (1996) (discussing Hart, who observed that custom lacks "secondary rules," i.e., "rules controlling rules"); see also Schauer, supra note 17, at 2 (discussing prescriptive rules). The rewards can be wholly intangible, such as relieving tension by joining a group that is similarly (miserably) situated. See Turner, supra note 2, at 30. More to the point with respect to the rela-
an existing norm by increasing the cost of defection. Law can also change the patterns of behavior by creating norms. Note that norm entrepreneurs who create a norm simultaneously destroy another; the law is an effective tool for both. Once a pattern of behavior exists, the law can also work to expand its application into new arenas. This is the subject of Part III.A. Part III.B describes how law affects norms in a manner akin to an epidemic: little effort is needed to create a huge effect if the norm has not been internalized; far more effort is needed if the norm has been internalized. Finally, Part III.C discusses how, as the pressure to modify the behavior becomes more successful, it causes the behavior to overshoot the mark. A law intended to protect and diffuse the good faith norm can swing past the point of equilibrium, to the effect that the law is ultimately protecting those who, thanks to the law's support, have ceased to be vulnerable and have become dominant. It is at this point that the very norm of good faith demands that the pendulum swing be reversed. In contrast, it is less clear that an overarching norm of good faith will support a reversal of defection, precisely because defection will have at least partially destroyed the good faith norm.

A. Law Can Support, Expand, or Reverse an Established Norm

If norms were entirely self-enforcing, laws to enforce them would be redundant. It is in part because even internalized norms are not wholly self-enforcing that law is necessary. The law acts as a sheep dog, keeping down the defections. Law can also be used by norm entrepreneurs to change the direction of the flock; in that case, the sheep dog reverses a norm that exists in the relevant arena, either by expanding the reach of a norm that already exists outside the arena or by pure norm creation. After describing the law as a supporter and an expander of norms and as a tool of norm defectors, I will apply these lessons to the good faith continuum in the context of unincorporated businesses.

1. Law Can Support an Established Norm

When good faith is a norm that has been fully internalized, the norm will be largely self-executing.\textsuperscript{38} Despite such a situation, however, certain members will have incentive to defect unless laws restrain them.

\textsuperscript{38} See TURNER, supra note 2, at 144 (noting that, by implication from definition of normative influence, internalized norm will be largely self-executing).
If the environment relating to particular conduct is neither infinitely iterative nor relational, it will not be conducive to self-executing norms: even if most members of a community conform to a particular standard of performance because they have internalized the norm, some member of the community or a person from outside the community may recognize that acting opportunistically will be to that person's immediate, short-term benefit. That conclusion is compatible with the learning of the game theorists and the relational contract theorists: the convergence of interests that leads to cooperation occurs when there is an infinitely iterative or a truly relational context. But whether or not there is an iterative or relational relationship, the law can increase the incentive to cooperate by penalizing defection, thus increasing the relative benefit of cooperation. A law that supports the good faith norm increases the likelihood of the other party's cooperation and thereby reduces agency costs by reducing the need for monitoring. Note that the impact of law in support of good faith should be particularly noticeable when the good faith norm has not been fully internalized because, in that situation, compliance normally would depend greatly on surveillance. By changing the calculation of any potential defector, therefore, the law can serve very effectively both as a stick and as a carrot. The law effectively changes the rational equation to make cooperation more attractive and defection more costly.

Commercial situations often are both imperfectly iterative and imperfectly relational. The classic insider trading situation is a good illustration. The insider either sells securities of the insider's corporation because the insider possesses nonpublic information to the effect that the price of the securities will fall, or buys those securities based on information

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40. See supra Part II.A (discussing empirical and theoretical research into conditions for cooperation); see also Bratton, supra note 32, at 166 (considering relationship between game theory and norms).


42. TURNER, supra note 2, at 144.

43. See infra Part III.B (noting that sheep dog role of law is so important because defectors can destroy norm).

indicating that the price of the securities will rise. If the trade is effected
in the public markets, the insider in its private capacity will typically have
neither a repetitive nor a long-term relationship with the other party to the
trade. Barring a law to the contrary, it is in such a context that the insider
will have incentive not to cooperate, that is, an incentive to act opportu-
nistically. Here the law can impose penalties on defectors to raise the cost
defection and increase the relative benefits of cooperation.

2. Law Can Expand the Application of a Norm into New Arenas, and
Such Expansion Includes Defection from the Old Norm

An existing norm can expand into a new arena. In this circumstance,
the new behavior expected by the new law may look like a new norm, but
may be only an application of an existing norm to a new set of circum-
stances. For example, before the stock market crash of 1929 the majority
view was that the information a director obtained as a corporate insider was
a perquisite of the position as director. Consequently, it was entirely

45. Even the empiricists' reputational constraints, see Macaulay, supra note 1, at 63,
would be less persuasive in a one-shot or nearly one-shot transaction.

46. See supra note 15 (discussing lawyer-economists' view of opportunism).

47. This Article focuses on expansion into a new topic area, but the expansion also
could be into a new community. For example, it could be the introduction of arbitrageurs
to the good faith norm, in the form of a rejection of insider trading. Arguably, the commu-
nity of arbitrageurs has not adopted that norm. See Laurence Zuckerman, Arbitragers Are
Back in Action These Days, L.A. DAILY NEWS, Dec. 5, 1994, at B6 (arbitrageurs are members of secretive club). That there is a different norm for the arbitrageurs' community is
evidenced by the fact that the Securities and Exchange Commission (SEC) has been
determinedly after them for insider trading. See Harvey L. Pitt & Karen L. Shapiro,
Securities Regulation by Enforcement: A Look Ahead at the Next Decade, 7 YALE J. ON
REG. 149, 153 n.8 (1990) (discussing regulation of arbitrageurs); see also JAMES B.
STEWART, DEN OF THIEVES 30-31 (1991) (discussing change of arbitrageurs from low-risk,
price-discrepancy traders to high-risk traders speculating on information about takeovers);
Ann Monroe & Ed Leefeldt, Insider Trading Case Appears to Damp Wall Street Gossip,
WALL ST. J., May 21, 1986, at 2 (arbitrageur impliedly admits that there is much trading
on inside information). Information is the core of the business. For example, Martin
Siegel, then of Kidder Peabody and later a prominent insider trading defendant, reportedly
"assumed" at first that arbitrage worked on "tips, hints, nods . . . [stopping] just short of
the actual passing of inside information," and that the reliability of the "tip" would be
independently assessed by the recipient. STEWART, supra, at 155. In 1984, Siegel did not
stop "just short" and traded on inside information with Goldman Sach's arbitrage partner,
Robert Freeman. Id. at 156-61.

48. See Sunstein, supra note 36, at 2043 (discussing how law can bring recognized
norm from one area and use it to replace disliked norm in another area).

49. I am assuming that the precrash norm tolerated abuse by the dominant, as one
would expect to some degree from a legal system awakening from Social Darwinism. See
acceptable for a director to use that information when trading in the corporation’s securities.\footnote{See Goodwin v. Agassiz, 186 N.E. 659, 660-63 (Mass. 1933) (finding nothing wrong with director trading on insider information in public market); WILLIAM L. CARY & MELVIN A. EISENBERG, CORPORATIONS 814 (7th ed., unabr., 1995) (discussing precrash view of insider trading).} After the passage of the 1934 Act, such trading on material, nonpublic information became prohibited by Section 10(b). Nevertheless, it was not until the United States Court of Appeals for the Second Circuit decided SEC v. Texas Gulf Sulphur Co. that a recognition of Section 10(b)'s reach seemed to enter the mores.\footnote{SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).} For example, one of the named defendants in Texas Gulf Sulphur was a senior engineer who was proudly described in Life magazine by the following caption next to his smiling photograph: "Kenneth Darke, a Texas Gulf engineer, supervised first strike, now plays the market on his own."\footnote{Billion-Dollar Plunge in the Bush, LIFE, May 15, 1964, at 36, 38.}

Perhaps this engineer was unaware of the standards applicable to his actions because he did not belong to the community of business mavens? That cannot be the full explanation. A very sophisticated businessman, Thomas S. Lamont, found himself caught in the same discontinuity between law and norms when he gave information about Texas Gulf Sulphur Company to another company, Morgan Guaranty Trust Company.\footnote{See Thomas Lamont, Banker, 68, Dead, N.Y. TIMES, Apr. 11, 1967, at 1. Thomas S. Lamont was a son of a J.P. Morgan founder, a partner of the firm in his own right, and at the same time, Vice Chairman of the Board of Morgan Guaranty Trust Company. Id.; Texas Gulf Sulphur Co. Bought in April by 2 Officers, Director, N.Y. TIMES, Apr. 14, 1964, at 49. He was also on the Texas Gulf Sulphur board. Id. Earlier on the day when Texas Gulf Sulphur granted a full press conference to disclose an extraordinary mineral strike, the Texas Gulf Sulphur directors were informed of the strike. Id. Presumably focusing on his fiduciary duty as director of Morgan Guaranty, Mr. Lamont telephoned the head of Morgan Guaranty’s trust department to tell him to "look at the broad tape." Eileen Shanahan, S.E.C. Insider Suit Names Texas Gulf Sulphur Aides, N.Y. TIMES, Apr. 20, 1965, at 1 (discussing Lamont's actions); Conversation with Professor Robert Boyden Lamb, New York University Stern School of Business (June 21, 1996) (discussing Lamont's intent). This call occurred ten minutes after the end of the press conference. Shanahan, supra, at 1. The SEC did not claim that Mr. Lamont had benefited personally}
understand that Mr. Lamont risked liability as a tipper. At the time, according to personal conversations with his family, Mr. Lamont was focused only on his fiduciary duty as a director of Morgan Guaranty. Convinced that his behavior had been correct, Mr. Lamont died not long after his trial, still confused by the Securities and Exchange Commission’s (SEC) treatment of his actions.

The government, including the SEC and the Justice Department, continued to push their efforts in norm entrepreneurship. During the takeover feast of the 1980s, there was ample opportunity to use material nonpublic information. A person who knows in advance that the raider will make a tender offer for a target has virtually certain knowledge that the target’s shares will rise upon the tender offer’s announcement. This certainty takes fair play out of the equation. Before passage of the 1934 Act, insiders were dominant—they used information that was not theirs for their own benefit and at the expense of the public. Even before the

from the call to Morgan Guaranty. See Texas Gulf Sulphur Officer Accused by SEC of Profiting by Inside Data, WALL ST. J., Apr. 20, 1965, at 3. However, Morgan Guaranty purchased Texas Gulf Sulphur shares, and the SEC pursued Mr. Lamont.

See generally Dirks v. SEC, 463 U.S. 646 (1983) (defining tipper and what it is to benefit from tipped information). Ten minutes after the Texas Gulf Sulphur press conference, the information was not yet public. See SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307-08 (2d Cir. 1971). The district court ultimately dismissed the charges against Mr. Lamont because his actions had occurred after the press conference. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 290 (S.D.N.Y. 1966). In other words, even district court Judge Bonsal got it wrong. On appeal, the Second Circuit chastised the district court for that dismissal. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854 n.18 (2d Cir. 1968).

As further indication of Mr. Lamont’s naiveté when his actions are viewed with 20/20 hindsight, and as further indication of the district court’s similar confusion, note that the charges against Mr. Lamont were dropped even though there was a fairly clear indication of personal benefit; he had actually purchased Texas Gulf Sulphur shares for his family two hours after the press conference. Mining Insiders Explain Deals, N.Y. TIMES, May 16, 1964, at 30.

See supra note 53 (discussing Mr. Lamont’s life and death).

This is not to denigrate pre-Texas Gulf Sulphur enforcement efforts, including the SEC’s administrative decision in Cady, Roberts & Co., 40 S.E.C. 907 (1961). Rather, it is a recognition that Texas Gulf Sulphur — because of the extreme visibility of the mineral strike — brought the issue of insider trading into the public consciousness to a degree that had not been the case before. In Cady, Roberts, the defendant was a stockbroker. See id. at 907-08. In Texas Gulf Sulphur, the defendants included a senior official of a commercial bank and an engineer. See supra notes 52-53 and accompanying text (describing Texas Gulf Sulphur defendants).

In this example, the information belonged to the raider.

Persons who, in ignorance, sell a target’s shares before the tender offer becomes public lose an opportunity precisely because of the buyer’s use of undisclosed inside
1980s, buying a target’s securities before the announcement while in possession of such information was unambiguously a Section 10(b) violation. We did not need *Texas Gulf Sulphur* to know that. The problem was that persons with access to information about an impending takeover assumed that they would not be caught, and therefore, they traded despite Section 10(b)’s prohibition. An implication is that the don’t-trade-on-inside-information norm still had not been fully internalized, and therefore, the government fought back with criminal prosecutions. The defendants in the criminal cases of the 1980s included an investment banker who salted away almost $12 million as well as a financial printer’s employee who earned only about $29,000. Implicit in the government’s showmanship when it hauled traders off the trading floor in handcuffs was the recognition that the norm still had not been internalized. In an effort to get its message across, the government used all available weapons, from financial penalties to incarceration, with shame somewhere in the mix.

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59. In *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC penalized a broker who traded in securities (for his own account and accounts of others) while in possession of material nonpublic information. *Texas Gulf Sulphur* was more difficult because the materiality of the information was questionable given that test borings do not predict ultimate results with certainty and because the nonpublic nature of the information was also questionable given the timing of certain trades as compared with the timing of public disclosure. See supra note 54 (discussing *Texas Gulf Sulphur*).


61. Bryan Burrough, *After the Fall: Fates Are Disparate for Those Charged with Insider Trading*, WALL ST. J., Nov. 18, 1987, at 1; see Chiarella, 445 U.S. at 224. Chiarella was the first case of criminal liability imposed on a purchaser for Rule 10b-5 nondisclosure liability. The defendant’s sentence was one year in prison, suspended except for one month and a five-year probation. See United States v. Chiarella, 588 F.2d 1358, 1373, 1378 (2d Cir. 1978) (Meskill, J., dissenting) (disagreeing with imposition of liability, especially criminal penalties), rev’d in part, 445 U.S. 222 (1980); see also Chiarella, 445 U.S. at 235 n.20 (discussing defendant’s sentence).

62. The point has been made that law cannot influence norms if the public is unaware of the law. See Hyde, supra note 4, at 407-08. Some governmental efforts publicize the law. During the administration of then U.S. Attorney Rudolph Giuliani, three top traders were placed against the wall, frisked on Kidder, Peabody & Co.’s trading floor, then led away in handcuffs. Stephen J. Adler et al., *Litigator’s Legacy: After Advancing Use of Racketeering Law Giuliani Eyes Politics*, WALL ST. J., Jan. 11, 1989, at A1. All of the indictments against two of the traders and most against the third trader were eventually
Judicial activity was not limited to entertaining criminal prosecutions for insider trading. The courts also broadened the categories of potential defendants by pursuing the misappropriation theory. Chief Justice Burger's famous dissent in *Chiarella v. United States* was the first Supreme Court opinion to discuss the misappropriation theory. Seven years later, the Court granted the theory a four-to-four affirmance. Meantime, four circuit courts of appeals have adopted this expansive theory of insider-trading liability: the Second, the Third, the Seventh, and the Ninth. The misappropriation theory asserts that a person can violate Section 10(b)'s nondisclosure provisions if the person has traded in securities using material nonpublic information in violation of a duty owed. The duty, however, need not be owed to the securities' issuer. It could, for example, be owed to an employer and, because misappropriation cases often arise in the context of a takeover, the employer in turn would owe a duty to the raider, not the issuer-target. In the more aggressive cases, although the employee-tossed out, see John Riley, *Cleared Trader Takes a Swipe at Giuliani*, NEWSDAY, Aug. 23, 1989, at 47, but the shaming had been done. However, Michael Milken's shaming may have been less effective. A few years after Milken was sentenced to jail for multiple felonies, the business school of the University of California at Los Angeles hired him, see Francis X. Clines, *An Unfettered Milken Has Lessons to Teach*, N.Y. TIMES, Oct. 16, 1993, at 1, as did Ted Turner, see Peter Truell, *Turner Said to Defend Milken's Advisory Fee*, N.Y. TIMES, Oct. 13, 1995, at D5. Shame has been the subject of much discussion. See John Braithwaite, *Crime, Shame & Reintegration* 75-76 (1989) (discussing shame); Ami Etzioni, *The Spirit of Community* 141 (1993) (same); Sunstein, supra note 36, at 2029-30 (same). Shame has been applied as a political tool. See *Morning Edition* (NPR radio broadcast, June 10, 1996), available in 1996 WL 2814914 (Boston is shaming johns by having them do physical clean-up in Boston's red-light district). This is social influence at work. See Turner, supra note 2, at 34-36.


65. See infra Part III.C (discussing recent Fourth and Eighth Circuit decisions restricting misappropriation theory).


68. SEC v. Maio, 51 F.3d 623, 631 (7th Cir. 1995).

69. SEC v. Clark, 915 F.2d 439, 453 (9th Cir. 1990).

70. Consequently, the defendant need not be a director, officer, or other classic insider of that issuer. See cases cited infra note 71.

71. As to takeover scenarios, see *SEC v. Maio*, 51 F.3d 623 (7th Cir. 1995) (with
defendant would owe a duty to the employer, the employer’s duty would be hard to find.\textsuperscript{72}

The legislative branch also weighed in during the 1980s. Prior to passage of the 1934 Act, and again during the heyday of the 1980s takeovers, the government was concerned that the insiders were dominant and were abusing the public. With the passage of the Insider Trading Sanctions Act (ITSA) and the Insider Trading and Securities Fraud Enforcement Act (ITSFEA),\textsuperscript{73} the norm entrepreneurship of the government has turned the tide massively against insiders, at least in certain corners of the securities industry.\textsuperscript{74} Trading on inside information is no longer a perquisite of the job; since ITSA, insiders are at risk for more than three times their illegal profits — a far worse result for them than mere disgorgement of profits. Since ITSFEA, a person who trades within a short time of another’s trade that had used material nonpublic information in violation of Section 10(b) can sue the alleged violator in a private cause of action.\textsuperscript{75} Before ITSFEA,


\textsuperscript{74} See generally H. Nejat Seyhun, The Effectiveness of the Insider-Trading Sanctions, 35 J.L. \\ Econ. 149 (1992) (breaking securities industry history into pre-Chiarella, \textit{Chiarella} to ITSA, and post-ITSA; noting that generally trading decreases before earnings announcements and takeovers).

the primary hope of unhappy complainants was for an SEC investigation of
the alleged violators. Now the complainants, with their lawyers, can dig
in directly.\footnote{76}

Note that, as the law expands the norm of good faith into new catego-
ries of transactions, a preexisting norm is being destroyed and replaced.
That is, the expansion of the anti-insider-trading norm presupposes that
the new law encourages defection from the preexisting, pro-insider-trading
norm. The law's introduction of the new norm into a particular context is,
to the extent successful, necessarily the reversal of an existing norm. Thus,
it is a government-supported defection from that existing norm, as well as
a government-supported expansion of the new norm.

3. The Support, Expansion, and Defection Roles of Law
Applied to the Good Faith Norm's Evolution in the Context of
Unincorporated Businesses

Norm entrepreneurs have made a similar effort to modify norms in the
context of unincorporated businesses. Here, the effort has been to change
the good faith norm so that an actor's dominance and conflict would no
longer determine the standard's level on the good faith spectrum. When the
story starts, partnership law contains a high standard of performance. We
are all familiar with Justice Cardozo's famous formulation in \textit{Meinhard v.}
\textit{Salmon}:\footnote{77} A fiduciary is "held to something stricter than the morals of
the market place. Not honesty alone, but the punctilio of an honor the most
sensitive."\footnote{78} During the 1970s, this standard was in such good graces that
the courts expanded a modified version into the arena of closely held
corporations.\footnote{79} Then came the reversals.

\begin{itemize}
\item \footnote{76} This represents either the creation of a new norm, see \textit{infra} Part III.A.3, or
enforcement of a norm by modifying the actor's self-interest, see \textit{supra} Part III.A.2.
\item \footnote{77} 164 N.E. 545 (N.Y. 1928).
\item Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). For a discussion of the
power of this language, see Marleen A. O'Connor, \textit{How Should We Talk About Fiduciary}
Duty? Directors' Conflict-of-Interest Transactions and the ALI's Principles of Corporate
1976) (applying partnership standards to stockholders of close corporation); Donahue v.
Rodd Electrotype Co., 328 N.E.2d 505, 515-16 (Mass. 1975) (same); Smith v. Atlantic
is modified by the \textit{Wilkes} and \textit{Smith} cases, which allow the duty to be waived if there is a
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First, the Revised Uniform Partnership Act of 1994 (RUPA) was drafted to provide for a lowering of the mandatory minimum standard of performance and to import into partnership law the lawyer-economists’ contractarian perspective that had been evolving in the world of incorporated businesses. Subsequent to RUPA, the states began to adopt limited liability company (LLC) statutes, many of which track the RUPA concept of an unwaivable core of duties. Other states enacted LLC statutes that provide for waivers, and yet others do not refer to fiduciary duties at all.

This use of the law can be viewed in one of two ways. It may reflect a concerted defection from the good faith norm as reflected by the legitimate business interest. Wilkes, 353 N.E.2d at 663; Smith, 422 N.E.2d at 801, 803. Needless to say, the contractarians are prepared to go even further. See Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 436 (7th Cir. 1987) (Easterbrook, J.) (discussing in dicta contractual waivers of disclosure obligations).

80. RUPA §§ 103, 404. Although RUPA went through many iterations, a fairly complete draft was in circulation by 1992. Four years later, as of December 1996, only eleven states have adopted RUPA (Alabama, Arizona, California, Connecticut, Florida, Montana, North Dakota, New Mexico, Virginia, West Virginia, and Wyoming). In addition, Texas has adopted revisions based on RUPA. Of these eleven plus one, only eight have a fiduciary-duty section that tracks the opting-out provisions of Sections 103 and 104 of RUPA. Montana and Wyoming apparently have expanded the opting-out powers, while Florida may have further limited opting out. See also supra note 23 (concerning RUPA as attenuation of fiduciary duty).


82. See Wayne M. Gazur, The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role, 58 LAW & CONTEMP. PROBS. 135, 154-56 (Spring 1995) (discussing opting out with mandatory threshold). As of December 1996, Hawaii, South Carolina, Vermont, and West Virginia have adopted statutes based on the UNIF. LIMITED LIABILITY COMPANY ACT (ULLCA), 6A U.L.A. 425 (1995), which in turn, approaches fiduciary duties in a manner patterned on RUPA. See Gazur, supra, at 152-54 (waivers); id. at 148-51 (no express standards); see also Caryl B. Welborn, Avoiding Personal Liability to Co-Members, Partners and Third Parties: How Far Can the Partnership or Operating Agreement Go?, 249 A.L.I.-A.B.A. 323, 329-30 (1996). Limited partnerships fall back on the general partnership law with respect to the partners’ fiduciary duties. REVISED UNIF. LIMITED PARTNERSHIP ACT (1985) § 1105, 6A U.L.A. 302 (1995). Many states have adopted other unincorporated business forms, notably the limited liability partnership. However, the statutes authorizing these forms are often rudimentary; they provide the owners with limited liability, but the vast majority of other topics are still covered by general partnership law. See generally Larry E. Ribstein, Possible Futures for Unincorporated Firms, 64 U. CIN. L. REV. 319 (1996) (discussing new limited liability forms). With regard to the effect of statutes on the good faith norm, it is especially likely that the relevant public will know the statutory standard when a business organization can be formed only by a filing, because it is especially likely that a lawyer will be retained. See supra note 62 (recognizing that law has to be known if it is to influence).
trum because it permits application of a standard that lies near the good faith end of the spectrum without taking into account either the actor's conflict of interest or the level of the actor's dominance over the other party. Another view is that the contractarian norm entrepreneurs who have sought passage of RUPA and the LLC statutes support the good faith norm and believe that the statutes they propose similarly support that norm. Because the lawyer-economists emphasize freedom of contract, they consider power to be relatively evenly distributed between parties involved in a business formation. If the lawyer-economists have an accurate perception, it would be appropriate to apply a standard of performance that lies more on the good faith end of the spectrum, rather than toward the fiduciary duty end. My disagreement is based on a belief that lawyer-economists are using the wrong scale. I see uneven, hilly terrain where they see a level playing field. Because they are considering only sophisticated participants, the lawyer-economists' scale may be too large and too selective: if the scale is large enough, certain small patches of even the Himalayas will look flat. Or perhaps the scale is too small because they are considering society as a generic whole: if the scale is small enough, such as a snapshot from outer space, even the Himalayas in their entirety will look flat.

Because I see hills, I see relative dominance and vulnerability — that is, circumstances that require the application of the good faith spectrum. The contractarian support of broad opting out is inconsistent with this good faith continuum. Therefore, even though a difference of perception can explain the contractarians' efforts in favor of RUPA and the LLC form, those efforts act as a norm defection.

83. See infra Part III.B (noting that defection from norm can destroy that norm).
85. Ribstein, supra note 23, at 58-59 (emphasizing that partners "often negotiate in detail or are participating in sophisticated, idiosyncratic tax-motivated deals"). Presumably, deals will be less sophisticated now that the check-the-box regulations will replace traditional entity-classification. See Treas. Reg. §§ 301.7701-1, -2, -3 (1997) (as amended by T.D. 8697, 1997-2 I.R.B. 11).
87. See supra Part II.B (observing good faith norm on continuum and noting that position on continuum is determined by conflict and dominance).
B. How Law Is a Barrier to Defection and an Engine for Expansion

In this Article, I have assumed and shown by examples that norms can be changed by law. The principle is that if we take a large enough club, we can — at least to an extent — bludgeon behavior and, ultimately, expectations. Advertisers try to do it, politicians try to do it, and legislatures try to do it. But the underlying question remains: How does the club work? The same analysis applies to the support of an existing norm, to the expansion of such a norm, and to the converse, defection. We still do not know how much force the law will need to be an effective barrier to defection or an effective engine for expansion, and unless we have some inkling of the answer to that question, we cannot know when the law will be effective for either purpose. That is, we cannot know how large the club must be nor how often to apply it.

Recent work in sociology suggests that the effects of norm defection or expansion are nonlinear. That is, norms are sticky at the outer edges, but as they come close to a point of equilibrium (the "tipping point"), a tiny incremental effort will have a dramatic effect. For example, if a crime wave is at the tipping point because the relevant population is aging, it may take a very small effort — eradication of the so-called quality-of-life crimes such as loitering — to effect a dramatic lowering of the crime rate. Similarly, if norm entrepreneurs start the shift away from the norm of good faith, they can change the norm more easily if it is near the tipping point. Even if it is not, by persevering, norm entrepreneurs can ultimately create an avalanche, an epidemic.

Game theory also supports the view that, in a complex, multi-party environment, a sufficiently determined and sufficiently large group of objectors can successfully invade a territory of cooperators. Once defection begins, others may have the incentive to defect as well, in an accelerat-
In other words, the opportunists can absolutely reverse the norm of good faith. What does this tell us about the role of law in the context of the good faith norm? Law can effectively reduce the number and therefore the effectiveness of ad hoc defectors, thereby protecting the good faith norm from being destroyed by random opportunists. As noted earlier, the law can make defection more costly to the defectors and, therefore, cooperation relatively more attractive. The epidemic of defection is stopped by pushing the mass of defectors back from the tipping point, in part by reducing their number below the critical size necessary to be effective in reversing the norm.

Yet the law can take a more affirmative role as well. It can force an existing norm into a new arena, and the same analogy to epidemics applies. In the case of expansion of the norm of good faith, the law reconfigures the risks to create an epidemic of behavior compatible with the good faith norm, and it does so by placing the necessary pressure in the appropriate direction. That is, the law threatens the stick of punishment and, at minimum, offers the carrot of lower mutual monitoring costs in an effort to gain compliance. If the norm that directors should benefit personally from inside information has been internalized, as was apparently the case before the 1929 stock market crash, that norm is far from the tipping point and great affirmative pressure will be needed to change it.

Consider, finally, the unincorporated businesses. Before the 1980s, the norm that existed was a high standard from the good faith continuum, reflecting the conflict and dominion of the actor-owner. Then RUPA introduced a relatively contractarian flavor. The push in favor of RUPA, a uniform statute designed for state legislatures to adopt, reflects the norm entrepreneurs’ recognition of the importance of law as a tool for norm formation. To date, however, only eleven states have adopted RUPA as

92. Id. at 60. For example, when a customer begins to refuse to pay (perhaps by claiming that the goods are defective), other customers will have an increasing incentive to follow suit.

93. Directors do not "occupy the position of trustee toward individual stockholders in the corporation." Goodwin v. Agassiz, 186 N.E. 659, 660 (Mass. 1933). "Fiduciary obligations of directors ought not to be made so onerous that men of experience and ability will be deterred from accepting such office." Id. at 661.

94. See supra Part III.A.3 (comparing historical good faith norm in unincorporated business forms to current developments).

95. A fundamental modification in the existing norm for the standard of performance in partnerships had to be accomplished by statute because of the partnership standard derived from Section 21 of the UPA. See generally 2 ALLAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON PARTNERSHIP § 6.07 (1995) (discussing fiduciary duty under UPA);
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the applicable partnership statute. 6 Perhaps the power/conflict-based good faith norm has been internalized with respect to partnerships. In contrast, the astonishingly successful efforts to promote adoption of LLC statutes prove the potential effectiveness of norm entrepreneurship through statutes; the LLC scenario impressively illustrates the use of statutes to push through the tipping point. The norm entrepreneurs have effected a massive defection from the good faith norm, in favor of a freedom-of-contract norm that tends not to weigh dominance and conflict when establishing the standard of performance. 8 This rapid and apparently effortless success may mean that the good faith continuum had not been internalized for LLCs and that it was therefore near the tipping point. It may, instead, reflect massive pressure brought to bear. 9

C. Law Propels a Pendulum

What have we learned so far? The norm of good faith animates business law, 10 and is applied at levels determined by the actor's dominance and conflict. 11 The law in some cases supports the existing good faith norm. 12 The law can also act as a tipping agent and will, if successful,


6. See supra note 80 (discussing limited adoption of RUPA).


8. See supra notes 80-82 and accompanying text (observing that LLC statutes tend to lower standard of performance). If the business community interprets the contractarian support of opting out to low standards of performance as a refusal to perceive dominance or conflict, due to the assumption of a level playing field, the basis of any change worked by the new laws will be on tolerance for dominance and conflict, rather than relative tolerance for abuse. The impact may be slightly different because of the difference in focus, but the overall effect will be tolerance.


10. See supra Part II.A (discussing good faith norm in business relations).

11. See supra Part II.B (discussing good faith continuum).

12. See supra Part III.A (discussing role of law as supporter of existing good faith norm).
modify the norm. However, there is a further step. As the norm in favor of the vulnerable becomes predominant — and especially as it is progressively internalized — the law, by continuing to push in the same direction as the norm, will ultimately reverse the positions of the relatively powerful and the relatively vulnerable. For example, the pendulum can explain what appears to be a fundamental change since 1995 in the direction of insider trading law.

As described above, first came the years of norm expansion supporting the public against the ills of insider trading. Persons who do not have material nonpublic information about a particular company, but are in a position to have access to such information, are wary of investing in securities because of the difficulty of proving the negative. These investors know that if the company engages in a transaction after the investors have traded in the securities, it will be virtually impossible to prove that they did not possess inside information. Technically, the prosecution or the SEC has the burden of proving that the defendant had the information. But the Motel 6 investigation, in which the SEC went to the seventh generation of alleged tippee, indicates how aggressive the government is prepared to be in these cases. In the tippee environment, the SEC seeks to establish a near presumption that a person who receives information has asked where it came from, thereby giving the defendant-recipient the necessary scienter to be prosecuted if he or she does possess the information. This presumption does not ease the government's need to prove that the alleged tippee had the information, but the government's use of plea-bargaining encourages alleged tippers to discuss everything with the SEC. Consequently, persons in the venture capital industry — those in the business of dealing

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103. See supra Part III.B (discussing law as barrier to change and as engine of change).
104. See supra Part III.A.2 (discussing expansion of good faith norm to insider trading context).
105. Floyd Norris, The Labyrinth of 2 Insider Cases, N.Y. Times, Mar. 8, 1995, at D1. The SEC has been successful. The most recent judgment in the Motel 6 investigation was for $3 million. S.E.C. Judgment in Motel 6 Case, N.Y. Times, Feb. 8, 1997, at 37.
106. See Fischel, supra note 60, at 101 (describing then U.S. Attorney Rudolf Giuliani's announcement that Dennis Levine was cooperating). That does not necessarily mean that the person in Levine's position would lie, that is, that the person would say that information had been transferred when it had not. But plea bargaining is a powerful weapon. Consider Ivan Boesky, for example, who agreed to be wired for sound, to have his telephone tapped, and to have his office meetings videotaped as part of his arrangement with the SEC. See James B. Stewart & Daniel Hertzberg, Grand Jury Is Said to Be Probing Drexel for Possible Criminal Securities Violations, Wall St. J., Nov. 19, 1986, at 3; see also Note, Insider Trading, SEC Decision-Making, and the Calculus of Investor Confidence, 16 Hofstra L. Rev. 655, 697 n.178 (1988) (concerning SEC's reasons for accepting pleas).
in securities for their own account and for the account of others — fear to trade even when they have no inside information, but rely purely on publicly available information.\(^\text{107}\)

Since 1995, two circuit courts of appeals and Congress have reacted against this trend in favor of insider trading plaintiffs. The Fourth Circuit in *United States v. Bryan\(^\text{108}\)* and the Eighth Circuit in *United States v. O'Hagan\(^\text{109}\)* have claimed that the misappropriation theory exceeds statutory limits.\(^\text{110}\) According to these courts, the misappropriation theory fails in the statutory context because the theory finds a violation even when no one connected to the defendant's transaction has been deceived, and this in turn results in a virtual guaranty of equal disclosure to all in the markets — precisely the concept rejected by the Supreme Court in *Chiarella*.\(^\text{111}\)

Although the Fourth and Eighth Circuits have not articulated that an emerging tendency to abuse insiders with the misappropriation theory has motivated their recent decisions, it is certain that these circuits, in breaking with the Second, the Third, the Seventh, and the Ninth Circuits,\(^\text{112}\) have generated decisions hostile to the earlier shift towards a balance favoring securities law plaintiffs.\(^\text{113}\)

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108. *United States v. Bryan*, 58 F.3d 933, 950 (4th Cir. 1995). In *Bryan*, the defendant, as the West Virginia Lottery Director, learned information confidential to his employer about bidders for the Lottery's video lottery business. *See id.* at 937-39. On the basis of that information, the defendant traded in the bidders' shares. *See id.* at 939.


110. *See supra* notes 63-72 and accompanying text (describing misappropriation theory).


112. *See supra* notes 66-69 (citing cases supporting misappropriation theory).

113. It is difficult to compare a legislative trend with a judicial trend. The legislature, subject to the appropriate constitutional and political realities, can express its views — including any hostility — directly. By contrast, when the courts deal with insider trading, they must consider the principles of statutory interpretation generally and of interpreting securities statutes specifically. *See generally* William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621 (1990) (discussing conflicting rules for statutory interpretation); Roberta S. Karmel, *Implications of the 'Central Bank of Denver Case'*, N.Y. L.J., June 16, 1994, at 3 (discussing interpretive rules of construction applied in *Central Bank of Denver* case). Nevertheless, to the extent that even Justice Scalia's new formal-
Hostility to the pro-plaintiff shift, on the other hand, was an expressly articulated reason for passage of the Private Securities Litigation Reform Act of 1995 (Reform Act). This statute may have been badly drafted, but its purpose is to restore balance. Private causes of action will be harder to institute: the statute restricts class actions by requiring the court to appoint a lead plaintiff. It makes private causes of action more risky for the plaintiff's lawyers because it imposes mandatory sanctions in the event of a violation of Federal Rule of Civil Procedure 11(b). It makes private causes of action less rewarding for the private plaintiff by substituting proportionate liability for joint and several liability, unless the plaintiff can prove that the defendant acted not only with scienter but with actual knowledge. As a practical matter, by making private causes of action more difficult and more dangerous to instigate, the Reform Act limits who will be a defendant.

ism and new textualism "potentially expands upon the judge's range of discretion by his revival of the notoriously numerous and manipulable canons of construction," Eskridge, supra, at 675, hostility may well show through even an assertedly plain meaning interpretation.


115. For example, the safe harbor applies only to private causes of action but not as protection against the SEC — of what use is a safe harbor against only one group of potential complainants? Note, however, that the SEC had previously promulgated, for example, Rule 3b-6 under the 1934 Act, 17 C.F.R. § 240.3b-6 (1996), which provides a limited safe harbor for certain forward-looking statements made in good faith. In addition, the judicial "bespeaks caution" doctrine seeks to achieve a similar result. See, for example, the discussion of the doctrine in In re Numerex Corp. Securities Litigation, 913 F. Supp. 391, 396-402 (1996).

116. See Reform Act, sec. 101(b), § 21D, 109 Stat. at 743-49 (amending 1934 Act by adding Section 21D and including presumption that lead plaintiff is plaintiff with "largest financial interest in the relief sought by the class").

117. Id. sec. 101(b), § 21D(c)(3), 109 Stat. at 748 (amending 1934 Act by adding Section 21D(c)(3)).

118. Id. sec. 201, § 21D(g) (amending 1934 Act's new Section 21D). With proportionate liability, the plaintiff no longer has the option of merely going after the deep pocket and then leaving that defendant to seek to recoup from other violators of the 1934 Act's Section 10(b).

119. In the misrepresentation area, Reform Act Section 102 effects that result directly by creating at least a limited safe harbor against certain private causes of action. See
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Therefore, these courts of appeals and congressional decisions since 1995 can be interpreted as a return swing of the pendulum. The previously dominant insiders have become relatively vulnerable because prior law supported plaintiffs against insiders. The vectors of both the anti-insider-trading norm and the law pushed in the same direction — across the tipping point and into territory where the roles have now been reversed. As perceived by these lawmakers, the newly vulnerable insiders are now protected from the newly dominant public. Although seeking balance, the law still supports the good faith norm.

What has been happening in the past ten years with respect to unincorporated businesses has also been a norm change supported by law, but instead has been away from the good faith norm. The consequences remain unclear. The push for adoption of statutes that lean toward opting out of fiduciary duties with respect to partnerships first and then LLCs represents an effort to create a new norm through a massive defection from the existing good faith norm. The efforts of these contractarian norm entrepreneurs have overwhelmed the tipping point, at least as to LLCs, leading to an extraordinarily rapid expansion of the contractarian concept. Although the contractarian’s norm creation efforts in favor of a new freedom-of-contract norm reinforce defection from, rather than support of, the good faith norm, the path traced has been the same as in the insider trading context. To the extent that the good faith norm was internalized, reversal of the norm has been more difficult than if the norm had not been internalized, and the norm apparently has been more resistant in the context of partnerships than


120. On November 5, 1996, California citizens voted decisively against the California referendum item named Proposition 211. See Ballot Initiatives Around the Nation, N.Y. Times, Nov. 7, 1996, at B7 (noting that 74% of voting Californians voted against Proposition 211). The referendum would have reversed some of the Reform Act’s effects by making plaintiff class actions for securities fraud easier to bring in California. See Proposition 211, § 3, 1996 Cal. Legis. Serv. Prop. 211 (West) (rejected). The rejection can be interpreted as the public’s expression in favor of the Reform Act’s support of relatively vulnerable insiders. In fairness, however, it is difficult to be clear about the public’s message given the heated rhetoric that preceded the referendum. See Neil Orman, Tech Firms Rally Tough Against California’s Prop. 211, Austin Bus. J. (Tex.), Nov. 1, 1996, at 3 (noting that Proposition 211 has national antibusiness tendencies); Don’t Be Fooled by Sales Job: Prop. 211 Written to Benefit Lawyers, Bus. J. (San Jose), Nov. 4, 1996, at 10 (asserting that Proposition 211 is pro-trial lawyer); Wall Street Investors Turning Attention to National, State Elections: Tech Companies Fight Proposition in California, Atlanta J. & Const., Nov. 3, 1996, at G4 (noting that Proposition 211 would limit disclosure by management to shareholders).
LLCs. The critical question is: What will happen to the pro-freedom-of-contract vectors, now that they have crossed the tipping point for destruction of the good faith norm in the context of LLCs, and as they continue to push toward destruction of that norm in the context of partnerships?

This is where we are today. With respect to insider trading, the recent changes in the law can be explained as a difference in perception that drives the pendulum back for the overall purpose of supporting the norm of good faith. The pendulum of the norm arguably has swung to its apex in support of the public, and the law now has eased its support for those who were perceived as vulnerable, but are now perceived as dominant. The insider-trading law evolved at a time when the vectors of the good faith norm and the law coerced and protected in opposite directions. The law was not designed to have the vectors operating in the same direction, and so the argument goes, a correction is now needed to respect the good faith norm and to continue to protect those who are truly vulnerable. In contrast, with respect to unincorporated businesses, it is much more difficult to see the changes as supporting the vulnerable against the dominant. Instead, these changes support norm defectors who destroy the good faith norm in the unincorporated business context. What remains unclear in the unincorporated business arena is whether the new freedom-of-contract norm has so far swamped the old good faith norm as to create its own pendulum, or whether it can still be driven back to swing on the pendulum of the overarching norm of good faith, assuming that the contractarians' perceptions are indeed misguided.

What we have seen already, however, is that law can be a very powerful tool in support of an existing norm, and we have seen hints of its power to expand or reverse a norm. Given the potential impact of law when it interacts with norms, we must consider when it is defensible for the law to intervene in these ways. In particular, we must consider whether it is appropriate for the law to support the vulnerable at the expense of the actor who has both dominance and conflict. This exploration is especially important with respect to unincorporated businesses because it is not at all clear that the pendulum has begun righting itself in this context. What should the role of law be?

121. As of July 1996, only eleven states have adopted RUPA. See supra note 80 (discussing limited adoption of RUPA). The adoption of LLC statutes has been by firestorm. See supra note 97 (noting widespread adoption of LLC statutes). See generally supra Part III.A.3 (observing RUPA and LLC statutes' trend away from good faith norm).
IV. The Good Faith Norm Is to Be Enforced: It Is Part of the Commons

Part II.B re-emphasized my earlier analysis that the standard of performance reflected in case law tracks a formula that assesses, among other criteria, the actor’s conflict of interest and relative dominance. This concept of a standard on the good faith continuum is an excellent vehicle to discuss the appropriateness of enforcement. The standard is a norm, as discussed above, and does not rely exclusively on its power as a norm for enforcement — it is in fact reinforced by law. For example, contract law and commercial law expressly enforce a requirement of good faith performance, and business law imposes a standard of performance at least as high.

A. It Is Defensible for Laws to Protect the Good Faith Norm if It Is Part of the Commons

It is one thing to contend that the laws interface with the norm of good faith. It is quite another to claim that because the relevant norm entrepreneurs believe that the community ought to conform to the particular norm, the norm is defensible on moral grounds. The fact that good faith is a

122. This is true even if described as a rejection of opportunism. See supra Part II.B (discussing good faith norm in relation to efficiency arguments). The major difference between anticompetitivism and good faith is that the former’s focus is to protect society by protecting efficiency, see supra notes 14-15, where the latter’s focus may be to protect the other participant in the transaction as well, see generally Dickerson, supra note 16 (analyzing good faith continuum from weaker party’s viewpoint). See Duncan Kennedy, Form and Substance in Private Law Adjudication, 89 HARV. L. REV. 1685, 1687-1713 (1976) (discussing standards versus rules); see also Lawrence E. Mitchell, The Death of Fiduciary Duty in Close Corporations, 138 U. PA. L. REV. 1675, 1682-88 (1990) (defining corporate fiduciary relationship); cf. William W. Bratton, Self-Regulation, Normative Choice, and the Structure of Corporate Fiduciary Law, 61 GEO. WASH. L. REV. 1084, 1099 (1993) (noting that American Law Institute’s Principles of Corporate Governance: Analysis and Recommendations may dilute fiduciary duties because, if disinterested directors decide, morals of marketplace “will henceforth determine the context of ‘fairness,’” thereby impliedly removing added protection of standards).

123. See U.C.C. § 1-203 (1992) (imposing good faith standard on, inter alia, performance of any "contract or duty" under UCC); id. § 2-103(1)(b) (defining good faith, in relation to the sale of goods in a commercial setting, as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade"); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); Dickerson, supra note 16, at 979-85 (discussing application of good faith continuum by commercial law found either at common law or in UCC).

124. See generally Dickerson, supra note 16 (analyzing good faith norm of business law in relation to other areas of law).
norm does not lead inexorably to the conclusion that this norm should be enforced. That is the greatest difficulty with the analysis of the Communitarians. The problem, of course, is that the relevant community may have a perfectly loathsome norm. When Amitai Etzioni, the father of Communitarianism, dealt with the problem of a police state that implicitly has its own norms, he lamely indicated that certain norms are so offensive that we must turn to higher order values, without explaining how to justify the definition of reprehensible that is adopted. Repression of identified minorities was a factual norm in Germany before and during World War II. I have no difficulty in recognizing it as a norm that ought to give way to higher order values. However, I need additional tools to explain this recognition and to predict when it will occur.

As noted in Part II, the standard on the good faith continuum is a norm in the business-commercial context as a factual matter, and schools from very different perspectives have (grudgingly, in some cases) accepted that good faith ought to be a norm. It is not merely that they, as norm entrepreneurs, think others should conform. Rather, they believe that, as a value, some level of good faith is preferable to bad faith. Even the lawyer-economists approve mandating nonopportunistic (non-bad faith) behavior because they consider opportunistic behavior to be inefficient. Essentially, they object to the actor externalizing costs by ultimately imposing the costs on society. Although shifting of costs is a problem, this is a weak, calculating tool for determining that a systematic repression is indeed indefensible. The realists tend toward positivism and approve the good faith norm because it exists. The realists focus on what is not bad faith and, arguably, on avoiding bad faith rather than on adhering to good faith. The problem with all these explanations is that they are negative. At best, therefore, they explain why persons should not behave opportunistically or in bad faith. They do not explain affirmatively why actors should behave in accordance with the good faith norm, that is, why the vulnerable should be protected, and why the law should affirmatively enforce the good faith standard.

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125. See Etzioni, supra note 62, at 37 (discussing higher order values).

126. To my mind, one of the most convincing illustrations of how incomplete an explanation calculativeness and opportunism offer is (inadvertently) contained in Oliver Williamson's effort to apply the former in a context clearly outside the business arena: sexual assault. See Oliver E. Williamson, Calculativeness, Trust, and Economic Organization, 36 J.L. & ECON. 453, 465 (1993). For a discussion of the interrelatedness of trust and calculation, see Bratton, supra note 32, at 165.

127. See Summers, supra note 10, at 196 (asserting that good faith "is a phrase which has no general meaning of its own, but which serves to exclude many heterogeneous forms of bad faith").
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A positive way to approach the minimum mandatory standard of good faith in the business-commercial context is to think of the good faith norm as part of the commons. We usually think of the commons in the context of environmental law, particularly when considering nonrenewable resources. The commons, for example, include the ocean and the atmosphere. But the ocean and the atmosphere contain nonrenewable resources, at least to the extent that the resources are expended faster than they can be renewed. When there are nonrenewable resources, the incentive to act as a free rider is potent: If a person harvests one more whale, cuts down one more rain forest tree, or pours into the atmosphere one more cubic meter of pollutants, that person appropriates one whole unit of the common good, but shares in only an infinitesimal part of the resultant cost. The other owners of the commons, together, bear the vast majority of the cost.

But wait. Why assume that the good faith norm is part of the commons? It may be tempting, instead, to consider that the good faith norm is infinitely renewable and, therefore, a pure public good. The argument would be that, unlike the commons, the good faith norm does not dimin-

128. Although some still refer to the ocean and the atmosphere as public goods, see Daniel C. Esty, The Greening of GATT: Trade, Environment, and the Future 67 (1994), it is hard to see them as infinitely abundant today, see Individual Actions and Collective Consequences, introduction to Rational Man and Irrational Society? 19, 31 (Brian Barry & Russell Hardin eds., 1982). For purposes of this Article, no one can be excluded from the benefits of a "pure public good," and it is infinitely abundant — a sidewalk that has just been cleaned, for example. See Eyal Benvenisti, Collective Action in the Utilization of Shared Freshwater: The Challenges of International Water Resources Law, 90 AM. J. INT'L L. 384, 388 (1996) (describing pure public goods). The relevant community is therefore in a state of "plenitude" with respect to a pure public good. See Carol M. Rose, "Enough, and as Good" of What?, 81 NW. U. L. REV. 417, 426 (1987) (defining "plenitude" as state in which there is not perceived scarcity). It is hard to conceive of a truly pure public good. Even the example of a recently cleaned sidewalk arguably may not be a truly pure public good; each dirty step is akin to the pollution described in Part IV.B of this Article. In any event, neither the ocean nor the atmosphere could be a pure public good under this rigorous definition.

129. Definitions are still fluid. Perhaps a renewable resource (or at least a nonexclusive one) can be a public good, see Paul B. Stephan, III, Barbarians Inside the Gate: Public Choice Theory and International Economic Law, 10 AM. U.J. INT'L L. & POL'Y 745, 749-50 (1995) (discussing public goods), but there the focus is not on one person making uncompensated use of a common asset. Rather, the focus is on the lack of any one party's incentive to create the common good, because that one person obtains only a fraction of the resultant benefit and grants the benefit to others. See supra note 128 (defining pure public good).

130. See supra note 128 (defining pure public good).

131. Persons can be partially excluded from common pool resources that are not infinitely abundant (for example, international freshwater). See Benvenisti, supra note 128, at 388. The "impure public good" is similar because it is not infinitely abundant, but no one
ish in value as it is used.\textsuperscript{132} We even could argue that good faith increases in vitality as it is used (that is, respected), because the norm is thus strengthened. Part IV.B shows, however, that the good faith norm is nonrenewable, and that its destruction harms all participants in the business arena. The systematic failure to act in accordance with the good faith standard is not merely opportunism (as the lawyer-economists say); it is the destruction of part of the commons\textsuperscript{133} and, for that reason, is indefensible.\textsuperscript{134} The protection of the commons will then be the positive goal.

**B. The Good Faith Norm Is Part of the Commons: The Law Should Support It**

If the atmosphere or the ocean represents the quintessence of the commons, then to the extent that the good faith norm shares with the atmosphere or the ocean those elements that define them as the commons, the norm can be considered the commons, too. Thus, the good faith norm must be of a nature that it can be abused by one person, with the effect that the abuse imposes costs on all others. Also, good faith must be nonrenewable.

Good faith can be compared to an ocean on the one hand and to the atmosphere on the other. When I use the image of an ocean, I focus on the analogy between defectors from the good faith norm and persons who overuse the ocean's resources — by overfishing, for example.\textsuperscript{135} When I use the image of the atmosphere, I focus instead on the analogy between

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\textsuperscript{132} See MARY DOUGLAS \& AARON WILDAVSKY, RISK AND CULTURE 116-17 (1982) (discussing increase in value of some public goods in inclusive groups).

\textsuperscript{133} The failure to comport with the good faith standard can be described as a "public bad." See Robert Cameron Mitchell, National Environmental Lobbies and the Apparent Illogic of Collective Action, in COLLECTIVE DECISION MAKING: APPLICATIONS FROM PUBLIC CHOICE THEORY 87, 99 (C. Russell ed., 1979) (distinguishing "public goods" from "public bads").

\textsuperscript{134} See supra text accompanying note 46 (discussing incentive to act opportunistically).

\textsuperscript{135} Overfishing is an example of overuse of the ocean's resources. See James M. Acheson, The Lobster Fiefs Revisited, in THE QUESTION OF THE COMMONS 37 (Bonnie J. McCay \& James M. Acheson eds., 1987); see also ESTY, supra note 128, at 15, Fig. 1.1 (discussing declining fishing harvests caused by overfishing). But see id. at 17-18 n.7 (referring to ocean pollution).
defectors and polluters.\footnote{136}{E.g., Esty, supra note 128, at 15 (discussing problem of polluters). But it is possible to think of animals (including humans) as using up oxygen, especially as the rainforests dwindle. See id. (advocating shift of focus from big industries to individual behavior).} Taking the overfishing analogy first, it is relatively straightforward to understand why one person should not use up an asset of general benefit that is located in the commons. If we consider that norm defectors use up a supply of good will and trust when they act below the good faith standard, the analogy is complete. Those who have dealt with the norm defectors and those who have heard of the norm defectors' dealings will have less confidence in the good faith norm because, after that bad experience, they will be unsure how others will behave. Therefore, by behaving according to a standard below the good faith norm, the defectors have obtained a benefit and have eroded the existing norm.\footnote{137}{See Francis Fukuyama, Trust: The Social Virtues and the Creation of Prosperity 150 (1995) (noting that United States has tendency toward "social atomization" and that looking out for individual interests can explain United States' loss of social capital during last fifty years).}

The pollution image, on the other hand, carries with it the difficult analogy of the polluter located on private property rather than in the commons. The good faith norm easily fits this difficult analogy if we consider a breach of the duty of good faith in a particular contract. However, even if we view the contract in a nineteenth-century fashion (that is, as being a one-off, private relationship between two isolated participants) and seek thereby to consider the mandatory good faith provision to be the contracting parties' asset, the obstacle is not insurmountable. Inherent in environmental law is the understanding that the collective whole, where it is adversely affected by the actions of one person, can regulate that person's activities, especially if the effect of those activities reaches beyond the actor's own property.\footnote{138}{See Esty, supra note 128, at 52 (asserting that harm to neighbors trumps sovereignty concerns).} The question is whether we can show that one person's violation of the norm of good faith in even the most isolated contract between two willing participants adversely affects the community at large.\footnote{139}{See Benvenisti, supra note 128, at 388 (discussing common pools); see also H. Scott Gordon, The Economic Theory of a Common-Property Resource: The Fishery, 62 J. POL. ECON. 124, 134-35 (1954) (observing that baronial manor had commons that were regulated, and that although common property is not sufficiently valued, it can be successfully regulated by such rules as "bag limit per man"). For a discussion of the commons as a testing ground for norms, see Eric A. Posner, Law, Economics, and Inefficient Norms, 144 U. PA. L. REV. 1697, 1740-43 (1996).} The answer is that, by acting in violation of the good faith norm, the contracting
party is similar to a factory owner whose factory is located entirely on the owner’s property but pollutes all the atmosphere. If people act according to a standard lower than good faith, they pollute the commons by infecting the good faith norm. Those who witness the effects of the defection will tend to become less trusting. Applying this principle systematically, the efforts of a determined norm defector, and especially the efforts of norm defectors acting in concert, can destroy the existing norm — in this case the norm of good faith — just as surely as the classic polluter destroys the atmosphere.

Based on either analogy, then, the efforts of the norm defectors leave those with whom they have dealt and those who have heard of their dealings with a diminished incentive to behave according to the good faith standard. Thus, the norm effectively is eroded. If we allow these raiders to erode the good faith norm, they are — as the lawyer-economists would say — increasing agency costs, and transaction costs generally, for the entire community. In other words, because norm entrepreneurship is effective, and because good faith is a part of the commons, norm entrepreneurs should not be allowed to arrogate that resource to themselves and thereby to erode this norm. Because defection will spread like an epidemic, the consequence of uncensored defection can be dramatic.

Hence, a role for law. Part of the law’s function in supporting the norm of good faith is to stabilize the norm against the raider-style norm entrepreneurs. Not only does law play that role, but also law should support the good faith norm as part of the commons. In fact, law should do more than merely support. The 1934 Act expanded the good faith norm, and the Second, Third, Seventh, and Ninth Circuits fur-

140. See supra Part III.A.1 (stating that law supports good faith against defectors); see also AXELROD, supra note 1, at 160-63 (commenting that raider can invade if nice strategy — here, good faith — is not territorially stable); supra Part III.A-B (discussing law’s role in protecting, modifying, abandoning, and replacing norms).

141. Professor Garrett Hardin discussed the overuse of natural resources on the one hand, and pollution on the other, as the two scenarios that define the tragedy of the commons. Hardin, supra note 131, at 1244-45.

142. Trust reduces transaction costs. See FUKUYAMA, supra note 137, at 27 (asserting that trust reduces costs of doing business).

143. See supra Part III.C (stating that, in effect, laws are tempering norm entrepreneurs’ impact); see also AXELROD, supra note 1, at 155 (asserting that government must maintain tough reputation and must elicit compliance from majority of governed by making obedience preferable).


145. Rothberg v. Rosenbloom, 771 F.2d 818, 822 (3d Cir. 1985), rev’d on remand,
thered the expansion by applying the misappropriation theory to nondisclosure cases under Section 10(b). Arguably, even the recent Fourth and Eighth Circuit decisions that rejected the misappropriation theory, as well as the new congressional restriction on private securities litigation, are in support of the good faith norm.

With respect to unincorporated businesses, the image is less clear. Although the Uniform Partnership Act of 1914 and its gloss support the good faith norm, RUPA has weakened it. To the extent that the good faith norm has not been destroyed, the pendulum may yet right itself. Therefore, the good faith norm may still be relatively intact with respect to partnerships. However, if the contractarian norm entrepreneurs have pushed their norm defection past the tipping point, they will have invaded and destroyed the good faith norm. With respect to LLCs in particular and unincorporated businesses in general, this may be the case. Destruction of the good faith norm is destruction of the commons. It is time to reverse the process.

V. Conclusion

The good faith norm that sweeps between contract law’s good faith and trust law’s fiduciary duty is the standard of performance that applies throughout business law. Although good faith is a norm, the law supports and modifies it. When the law’s support of the good faith norm becomes too effective, the relatively vulnerable party becomes dominant. It is then that the law will shift to protect the newly vulnerable in obedience to the overarching principle of good faith, as is arguably the case in certain areas concerning insider trading.

However, norm defectors can destroy the good faith norm. Any person who uses the law to create a new norm is, by definition, eroding the old norm. In the context of unincorporated businesses, evidence indicates that there has been a creeping destruction of the good faith norm, whether or not that is the intention. To the extent that the freedom-of-contract standard, as contemplated by the new unincorporated business statutes, fails

808 F.2d 252 (3d Cir. 1986).
146. SEC v. Maio, 51 F.3d 623, 631 (7th Cir. 1995).
147. SEC v. Clark, 915 F.2d 439, 453 (9th Cir. 1990).
150. See supra Part III.C (observing that insider trader law supports good faith norm).
to consider the relative dominance and vulnerability of the parties, those statutes are instruments of norm defection.

Because the norm of good faith is part of the commons, destruction of the norm is destruction of the commons. Therefore, we must reverse the unincorporated business statutes' opposition to the good faith norm. The good faith norm must be protected and reinvigorated in the context of partnerships, and an unapologetic good faith norm applicable to partnerships must become the basis for interpreting the standards applicable to other unincorporated forms, particularly the LLC. To allow the continued emergence of the freedom-of-contract norm, now apparently ascendant among LLCs, will further destroy the commons that is the good faith norm.